DOCUMENT RESUME

ED 306 323 UD 026 722

AUTHOR Shapiro, Isaac; Greenstein, Robert
TITLE Making Work Pay: A New Agenda for Poverty Policies.
INSTITUTION Center on Budget and Policy Priorities, Washington, DC.
PUB DATE 21 Mar 89
NOTE 27p.
AVAILABLE FROM Center on Budget and Policy Priorities, 236 Massachusetts Avenue, NE, Suite 305, Washington, DC 20002.
PUB TYPE Reports - Evaluative/Feasibility (142)

EDRS PRICE MF01 Plus Postage. PC Not Available from EDRS.
DESCRIPTORS *Employment; *Family Income; Family Programs; *Federal Legislation; Laws; *Low Income; Low Income Groups; *Minimum Wage; Minimum Wage Legislation; Poverty; Public Policy; Rural Family; *Tax Credits
IDENTIFIERS Policy Analysis; Policy Research

ABSTRACT

Restoring the value of the minimum wage and expanding the Earned Income Tax Credit (EITC) by family size could significantly reduce family poverty and "make work pay." Recent poverty policies have largely ignored those who work but still remain poor. The majority of these working poor are in their prime working years (aged 22 to 64), most are white, and a disproportionately large number live in rural areas. Most of the children living in poverty are members of working poor families. The largest single factor that has contributed to the increase in the number of the working poor since the late 1970s has been the drop in the value of the minimum wage. Restoring the minimum wage and expanding the EITC are complementary policies necessary to guarantee that parents working full-time and their children will not have to live in poverty. One reform may not substitute for the other. Restoring the minimum wage to its traditional level can bring full-time earnings back to the poverty line for a family of three. Reforms in the EITC can bring most families of more than three people up to, or close to, the poverty line if the family has one full-time worker. Proposed reform legislation is analyzed and compared. Statistical data are included on two graphs. Discussions of the value of the minimum wage, and the relationship between the minimum wage and employment opportunities are included in the appendices. A separate executive summary is also included. (FMW)

****
* Reproductions supplied by EDRS are the best that can be made *
* from the original document. *
****

4-12-89

ED306323

MAKING WORK PAY:
A New Agenda for Poverty Policies

U.S. DEPARTMENT OF EDUCATION
Office of Educational Research and Improvement
EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)

X This document has been reproduced as received from the person or organization originating it.

☐ Minor changes have been made to improve reproduction quality.

• Points of view or opinions stated in this document do not necessarily represent official OERI position or policy.

"PERMISSION TO REPRODUCE THIS MATERIAL IN MICROFICHE ONLY HAS BEEN GRANTED BY
Richard Civille
Center on Budget and Policy Priorities
TO THE EDUCATIONAL RESOURCES INFORMATION CENTER (ERIC)."

Isaac Shapiro
Robert Greenstein

March 21, 1989

CENTER ON BUDGET AND POLICY PRIORITIES
Washington, D.C.

CG 026 722

BEST COPY AVAILABLE

The Center on Budget and Policy Priorities, located in Washington, D.C., is an independent nonprofit research organization that provides analyses of government spending, programs and public policy issues that have an impact on low and moderate income Americans. The Center is funded by grants from foundations.

Isaac Shapiro is Senior Research Analyst at the Center, specializing in employment-related issues. He was formerly Research Associate with the Center for Social Policy Studies in Washington D.C., where he co-authored with Sar A. Levitan the recently published book *Working but Poor: America's Contradiction*.

Robert Greenstein is the director of the Center on Budget and Policy Priorities. He is former Administrator of the Food and Nutrition Service of the U.S. Department of Agriculture.

ACKNOWLEDGMENTS

The authors would like to express our intellectual debt to David Ellwood and Sar Levitan. We have learned much and borrowed heavily from their views on the working poor and possible policy responses.

We would also like to thank the many individuals at the Center on Budget and Policy Priorities who contributed to this report. Thanks to Scott Barancik, Cathy Carr, Ed Lazere, Paul Leonard, and Keith McKeown. We are particularly grateful to Richard Civille, Wendy Burnette, and Kathy Hill for their assistance in the preparation of this document.

We claim sole responsibility for interpretations provided and any errors that remain.

Center on Budget and Policy Priorities
236 Massachusetts Avenue, N.E., Suite 305
Washington, D.C. 20002
(202) 544-0591

Millions of people in this country work but remain poor. Nearly two million people worked full-time year-round but remained poor in 1987, while another six and one-half million people worked on less than a full-time full-year basis and remained poor.

Many of these 8.4 million poor workers supported spouses, children, and other dependents. Altogether, approximately 18 million people -- or *more than half* of the 32.5 million people who were poor in 1987 -- lived in households with a worker. Some eight million poor children -- nearly two-thirds of all the poor children in the country -- lived in working poor households.

The ranks of the working poor are much larger today than in the late 1970s. The number of individuals who work but are poor was 28 percent greater in 1987 than in 1978, even though both years represented similar points in the business cycle. The number of full-time year-round workers who are poor jumped 43 percent between 1978 and 1987.

The existence of such large numbers of working poor people runs contrary to the principle that work should yield some measure of economic security for wage earners and their families. It also runs contrary to the image of the poor held by many in this nation who think of the poor (other than those who are elderly) as a group of individuals who are largely indolent and irresponsible.

The welfare reform legislation enacted last year will have little effect on people who work but remain poor, with the exception of those working poor families that have recently left the welfare rolls. To a large degree, the working poor are ignored both by public opinion and government policy.

This state of affairs can be altered. Changes in public policy can be made that focus on one basic goal: *if a parent works full-time year-round, the parent and his or her children should not have to live in poverty.* This goal is consistent with the basic values of this nation and should be acceptable across the political spectrum. Policies to achieve this goal could make a major impact in alleviating poverty among poor families.

I. The Working Poor

The ranks of the working poor are considerably larger than is commonly recognized. The majority of the poor live in households in which one or more people work, often in full-time year-round jobs.

- In 1987 (the latest year for which poverty data are now available), 1.9 million people worked full-time year-round but remained poor. An additional 6.6 million people worked on less than a full-time year-round basis and remained poor.

- There were 32.5 million people living in poverty in 1987. Of these, an estimated 18 million -- or more than half of the poor -- lived in a household where at least one household member worked during the year.

An estimated five million lived in a household where at least one household member worked full-time year-round.[1]

This phenomenon of being poor despite working is especially widespread among families with children. Most of the children living in poverty in our country are children who are members of working poor families.

- Approximately 64 percent of all poor children -- or nearly two of every three -- live in families with one or more workers. More than eight million children lived in working poor families in 1987.

- More than two million poor children -- or one in six -- lived in families in which at least one person worked full-time year-round.

It should be noted, moreover, that a substantial proportion of the poor who do *not* work are people who would not normally be expected to work. Many are ill, disabled, or retired. Census data indicate that two-fifths (40.1 percent) of those heads of poor families who did not work in 1987 failed to work because they were ill, disabled, or retired.[2] Most others who did not work either looked for work but could not find it or were single mothers with young children. Most of the poor family heads whom the general public would expect to work actually do work.

- In 1987, three of every five (59.8 percent) poor family heads who were not ill, disabled, or retired worked for all or part of the year.

- Of those who did not work -- and were not ill, disabled, or retired -- more than half either looked for work but could not find it or were single mothers caring for at least one child less than six year old.

- Overall, fewer than one in five of those poor family heads who were not ill, disabled, or retired consisted of people who failed to work, failed to look for work, and who were not single mothers caring for children under the age of six. Moreover, many of those family heads who did not work or look for work -- and who were not single mothers caring for a young child -- were single mothers caring for children aged six or over.

Just as the extent of work effort among the poor is greater than is generally recognized so also do the characteristics of the working poor confound commonly-held stereotypes many Americans have of poor people.

---

1. The number of poor and poor workers come directly from U.S. Census Bureau data. The authors estimated the number of people living in working poor households through a series of calculations based on Census data.

2. The data are based on what family householders reported to the Census Bureau as their "main reason" for not working. Some 23.4 percent reported that their "main reason" for not working was that they were ill or disabled, while 16.6 percent reported their main reason for not working was that they were retired.

- *Most of the working poor are in their prime working years and are white.* Of the 8.4 million individuals who worked but remained poor in 1987, some 6.5 million -- or 77 percent -- were prime working-age individuals (people aged 22 to 64). Some 6.2 million -- or 73.6 percent -- were white.

- *Most of the 1.9 million people who worked full-time year-round but remained poor are men, and most of these workers live in two-parent families.* Some 71 percent of families that were poor in 1986 despite having a full-time year-round working head of household were families in which two parents were present. Some 60.9 percent of all workers who fell into poverty despite full-time year-round work were men. (Comparable data for 1987 have not yet been published.)

- *A disproportionately large share of the working poor live in rural areas.* In 1987, seven of every ten (70.5 percent) of all poor family heads in nonmetropolitan areas who were not ill, disabled, or retired worked for all or part of the year. The comparable figure in metropolitan areas was 55.4 percent.

  As a result, while 22.4 percent of the U.S. population lived in nonmetropolitan areas, an estimated 33.4 percent of the working poor families lived in these areas.

II. Growth in the Ranks of the Working Poor

Despite the economic recovery, there are substantially more working poor today than in the late 1970s. The proportion of working individuals who fall into poverty tends to rise and fall with overall economic trends. During recessions, wages are more likely to decrease in value, and employment is more likely to be for part of the year rather than for all of the year. As a result, the proportion of workers who are poor tends to rise. By contrast, during recoveries, wages are more likely to increase and workers are more likely to be employed throughout the year, so the number and proportion of workers in poverty tends to decline.

Yet while the number and proportion of workers in poverty has fallen since the end of the 1981 - 1982 recession, the improvement has been modest. As a result, much of the ground lost during the recession of the early 1980s has not been recaptured.

Indeed, the ranks of the working poor are considerably larger now than at a similar point of the late 1970s. This can be seen by comparing data for 1978 and 1987. Both years represented advanced stages of economic recoveries, and both had similar unemployment rates (the national unemployment rate was 6.2 percent in 1987 and 6.1 percent in 1978). Yet the number of working poor was sharply higher in 1987 than in 1978, and poverty rates among workers were higher, as well.

- In 1987, the number of poor people who worked full-time year-round was 42.9 percent greater than in 1978. There were 562,000 more people working full-time year-round but living in poverty in 1987 than in 1978.

- The number of people working at some point during the year (including those working less than full-time year-round) was 27.9 percent greater in 1987 than in 1978. This represents an increase of 1.8 million people who worked but remained poor.

- By contrast, the number of poor people on welfare (i.e., on the Aid to Families with Dependent Children program) did not change appreciably during this period. (The number of nonworking poor was higher in 1987 than in 1978, but a smaller proportion of the nonworking poor were receiving welfare.) Contrary to popular impressions, the large increases in the ranks of the working poor dwarfed the minor changes in the ranks of the poor on welfare.

- Finally, 6.6 percent of all workers were poor in 1987, compared to 5.9 percent in 1978. Among full-time year-round workers, 2.4 percent were poor in 1987, compared to 2.1 percent in 1978. These percentages may seem small, but given the overall size of the work force, they reflect large numbers of people -- and also large percentages of the poverty population.

The growth in the ranks of the working poor is consistent with another trend -- the widening gaps between high and low-income families with children. A recent Congressional Budget Office analysis of Census data found that from 1979 to 1987, the average income of the poorest fifth of families with children plunged 21 percent, dropping $1,757, after adjusting for inflation (see Figure 1). The next-to-the-poorest fifth of families with children also fared badly; their average income fell $1,584. The average income of the middle fifth of families with children stayed essentially the same, rising $61 (a scant 0.2 percent). But the average income of the wealthiest fifth of families with children rose $7,334 (or 11.2 percent).[3] This trend is especially relevant when considering the policy options that follow because, as noted, nearly two-thirds of poor children live in families with one or more worker, and because the policy options presented here are largely targeted to families with children.

The recent growth in income disparities has led to inequities in income distribution unparalleled in the era since World War II. Census data show that in

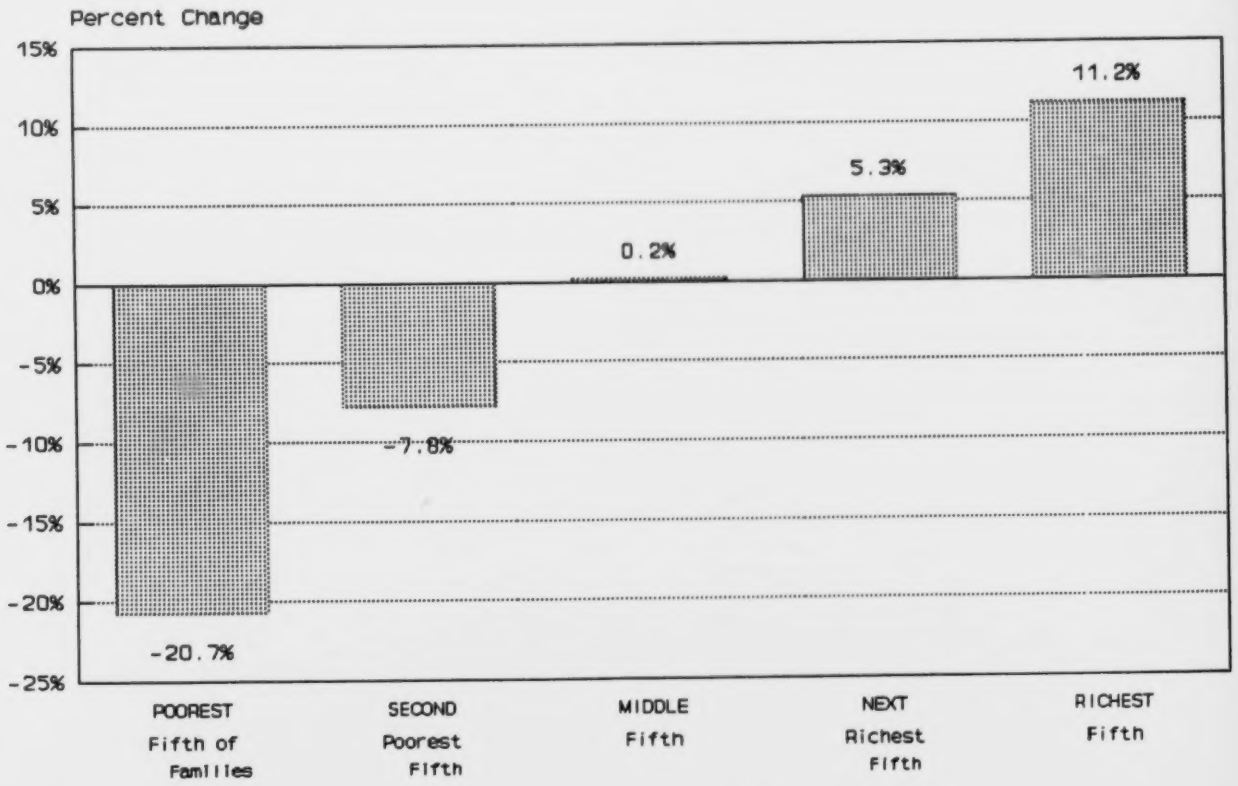
---

3. Although the CBO analysis does not provide data on the 1978-1987 period, economic conditions in 1979 were similar to those in 1978. Another recent CBO study, *Trends in Family Income: 1970 - 1986*, also uses Census data but makes adjustments in family income levels to reflect changes over time in family size. In this study, (as updated to include data for 1987), CBO found that the average income of the poorest fifth of families with children fell 21.3 percent from 1979 to 1987, the average income for the middle fifth of families with children edged down by 0.4 percent, and the average income of the top fifth of families with children grew by 12.9 percent. The various CBO analyses demonstrate that regardless of which of several methodologies are used, the income gaps between rich and poor families with children (and also between rich and middle income families with children) are found to have increased substantially since the late 1970's.

Figure 1

Change in Average Income of Families with Children

By Quintiles, 1979-1987



1987, the wealthiest 40 percent of families received a larger share of the national family income than in any other year on record (these data were first collected in 1947). The bottom 40 percent of families received a smaller share of the national income than in any other year on record except for 1986, a year in which they received the same record low share as in 1987. In short, the Census data show that in 1987, the gaps between high and low income families were the largest ever recorded.

Economic Factors Contributing to the Increase in the Ranks of the Working Poor

Several economic trends have contributed to the increase in the working poor and the widening of income gaps. First, the fall in the unemployment rate that has occurred in recent years has not been accompanied by a rise in wage rates for nonsupervisory workers. *In 1988, the average hourly earnings of private nonsupervisory workers were lower than in any other year since 1966, after adjusting for inflation.*[4] These wages were about $1 per hour -- or 9.4 percent -- lower in 1987 than in 1978, after adjusting for inflation.

Second, the wage growth that has occurred has been unevenly distributed, with a larger proportion of workers earning wages that, without other supplements, do not lift them out of poverty. Urban Institute economist Isabel Sawhill recently conducted a review of the studies of the distribution of wages. She concluded: "Economic growth need not lead to a reduction in poverty if it is accompanied by a greater dispersion of earned incomes around a (rising) average. And all of the evidence points to just such a phenomenon having occurred. The inequality in both annual and weekly earnings has been growing for several decades."[5]

On the public policy front, retrenchments in benefits programs at both federal and state levels have also contributed to the increase in poverty. Census data show that in 1979, nearly one of every five families with children that was poor before receipt of government cash benefits was lifted out of poverty by these benefits. By 1987, only about one in every ten such families was raised from poverty by government assistance.

Among those hardest hit by the retrenchments in benefit programs have been low income families that work. More than half of the low income working families that were on AFDC prior to the 1981 federal budget reductions were removed from the program by those changes. Major reductions over the years in state AFDC income limits and benefit levels (due largely to the failure to keep pace with inflation) also

---

4. This comparison uses the official government index of inflation -- the consumer price index. Some analysts, however, believe this index overstates inflation and thus the value of wages from years prior to 1983. But even if the alternative adjustment for inflation (the "CPI-X") used by these analysts is applied, the average private wage in 1988 was the lowest it had been in any year since 1970.

5. Isabel V. Sawhill, "Poverty in the U.S.: Why Is It So Persistent," *Journal of Economic Literature*, September 1988, p. 1090.

have primarily affected the working poor. Indeed, in 1976 a single-parent family of four with earnings equal to 75 percent of the poverty line qualified for AFDC in 46 states. By 1987, the family qualified in only seven states.

The earnings of the working poor have also declined because of the large drop in the value of the minimum wage, as explained below.

III. Making Work Pay

A strategy can be devised that consists of a series of measures -- outside the welfare system -- to "make work pay"[6] and thereby assist low income working families. The objective would be to fashion a coordinated series of reforms designed to achieve a fundamental goal: *if a parent works full time, the parent and the children in the family should not have to live in poverty.*

This goal is consistent with the basic values of this country and should be acceptable across the political spectrum. Currently, this goal is being expounded by liberals and conservatives alike. As an example of its widespread support, the goal is currently being promoted by the conservative Heritage Foundation.

"Making work pay" could lift many of the working poor -- especially many working poor families with children -- out of poverty or much closer to the poverty line. It could also have a strong work incentive effect, bringing more people into the labor market and making work relatively more attractive as compared either to public assistance[7] or to various illicit endeavors in the underground economy.

Reforms designed to "make work pay" should be of especially large benefit to rural areas, which contain a disproportionately large proportion of the working poor. About two of every three poor families living in rural areas include at least one worker and nearly one in four have two or more workers.

In the inner cities, the proportion of the poor who work is somewhat smaller. Yet the effects of "make work pay" reforms should be large there, too. A key policy

---

6. For an excellent discussion of the "make work pay" strategy, see David Ellwood, *Poor Support: Poverty in the American Family*, Basic Books, 1988.

7. This point should not be misconstrued. The benefits from working can indeed be less, or only minimally more, than the benefits from government assistance. However, this is because the rewards from working can be small, not because government assistance is especially generous. In fact, the support provided by government programs has diminished sharply in recent years and, in most cases, leaves recipients well below the poverty line. For example, in the typical (or median) state, AFDC benefits for a family of four with no other income fell 23 percent from 1978 to 1988, and 36 percent from 1970 to 1988, after adjusting for inflation. There is no state in the country where AFDC benefits come close to the poverty line (and only two states where AFDC and food stamp benefits combined equal the poverty line). In fact, in the typical (or median) state, the AFDC benefits provided to a family with no other income equal less than half of the poverty line.

goal in the inner city should be to transform the working poor more into role models who *do* escape poverty, through their effort, and to make them seem less like "chumps" who work all day at jobs that pay little more than what can be obtained through public assistance or minor hustling. A strategy to make work pay might in the long run prove to do as much (or more) to affect attitudes and norms in such communities as the exhortations for changes in values now so widely sounded.

Two steps could go a long way toward achieving the goal that a family with a full-time working parent should not have to live in poverty. (For the rest of this paper, "full-time" will be used to characterize workers who are employed "full-time" throughout the year.) One step would be to restore the minimum wage to its traditional level. The second would be to enlarge the earned income tax credit and adjust it for family size.

Restoring the minimum wage and expanding the earned income credit are not policies that can substitute for one another. Rather, they are complementary policies. Both are needed. If society sets a goal that families with children in which a parent works full-time should not have to live in poverty, then changing both the minimum wage and the earned income credit is necessary. Taking either step without the other leaves us well short of the goal.

At the outset, an important qualifier about the scope of the policies discussed in this paper should be noted. The minimum wage and the earned income credit are not the only policies that need modification in order to address the problems of the working poor. Most notably, adequate child care and health care coverage are lacking for many of the working poor, and policies in these areas (including a policy change to make the dependent care tax credit refundable, so that low income working families may benefit from it) need substantial strengthening as well. The policy changes needed in those areas are beyond the scope of this paper, but that does not diminish their importance. Our concentration here is on two wage support policies that can help achieve the aforementioned goal.

IV. The Minimum Wage

The federal minimum wage of $3.35 has not been raised since January 1981, even though the cost-of-living has risen 39 percent during this time.[8] This is the longest period without adjusting the wage floor since it was established in 1938. By a variety of measures, the minimum wage is now at an historic low. In particular, working full-time at the minimum wage no longer provides enough earnings to lift a family of three out of poverty, as it often did in the past (see Figure 2).

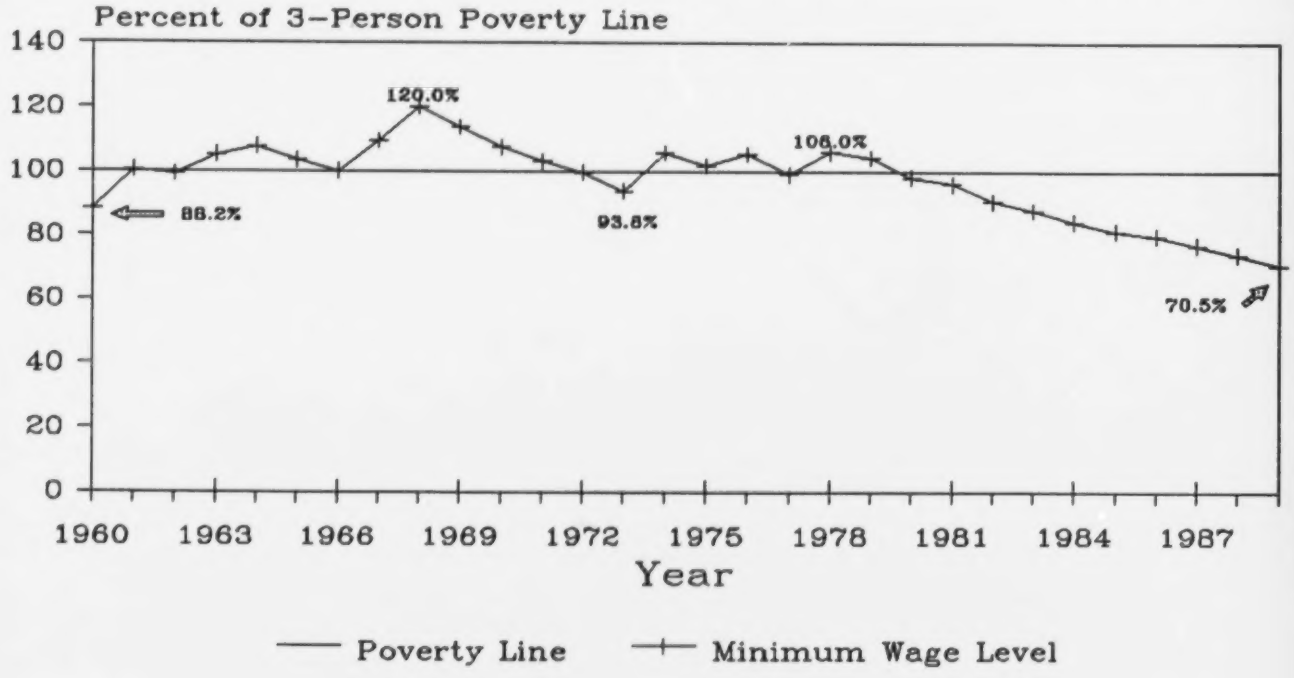
- After adjusting for inflation, the purchasing power of the minimum wage is at its lowest level since 1955.

---

8. The last round of minimum wage increases began in 1978, but did not keep pace with inflation. The real purchasing power of the minimum wage has declined every year since 1978.

Figure 2

Minimum Wage vs. 3-Person Poverty Line
(Earner Works Full-time Year-round)



- Throughout the 1960s and 1970s, full-time work at the minimum wage generally lifted a family of three out of poverty. During these two decades, minimum wage earnings averaged slightly above (103.6 percent of) the poverty line for a family of three.

- By contrast, in 1989, a person working full-time at the minimum wage will earn approximately *$2,900 (or 30 percent) less than the projected poverty line for a family of three.* (Full-time minimum wage earnings would be $6,968, compared to the projected poverty line for a family of three of $9,887.)

A large number of workers have earnings at or near the minimum wage. In 1988, there were 5.4 million hourly and salary workers who earned the minimum wage or less. Another 10.1 million workers earned $3.36 to $4.49 an hour. (The minimum wage would need to have been $4.53 an hour in 1988 to provide full-time earnings equal to the poverty line for a family of three.)

Most of these minimum wage workers do not fit the stereotype of a teenager in his or her first job. In 1988, half (50.3 percent) of those workers earning the minimum wage or less were 25 years or older, 20.6 percent were 20-24 years old, and only 29.2 percent were teenagers.

It is true, as opponents of restoring the minimum wage often note, that most minimum wage workers are not poor. However, what opponents of restoring the minimum wage often fail to acknowledge is that a majority of the working poor do have earnings at or near the minimum wage level. Congressional Budget Office data indicate that in 1987, nearly three of every five (57.2 percent) poor workers paid by the hour earned $4.35 an hour or less.

The minimum wage has a direct bearing on many workers in poverty. An increase in the wage standard would lift some of these workers out of poverty and would lessen the severity of poverty for others.

Moreover, from an economic standpoint, now is a good time to raise the minimum wage. Due to such factors as tighter labor markets, a reduced number of youths entering the labor market, and the low value of the current minimum wage, a minimum wage increase at this point in time would be likely to have only a small adverse effect on employment opportunities. (For a more detailed analysis of the value of the minimum wage and the effects of changes in the minimum wage on employment opportunities, see the Appendices.)

V. The Earned Income Tax Credit

The second leg of this strategy to "make work pay" is an expanded earned income tax credit that is adjusted for the number of children in a family. Restoring the minimum wage to its traditional level can bring full-time earnings back to the poverty line for a family of three. Reforms in the earned income credit, a tax credit for low

income working families with children, can bring most families of more than three people up to (or close to) the poverty line, if the families have a full-time worker.

Today, working poor families with several children face a difficult situation. Family needs increase as family size grows. Recognizing this fact, the poverty line rises with family size. Welfare benefits also increase with family size. But wages do not.

As a result, large working families with several children are more likely to be poor than are smaller families. Those large families that are poor are also likely to fall further below the poverty line than smaller families that are poor. Furthermore, as family size increases, low paid work becomes less and less competitive with public assistance.

What is needed is a wage supplement for working poor families that is geared to family size. The earned income tax credit (EITC) can be adapted to serve this purpose.

The EITC (which currently does *not* vary with family size) is available only to working poor families in which parents live with and support children. In 1989, most families with children and with earnings between $6,500 and $10,240 will qualify for the maximum credit, which equals $910. Fathers who have left their families do not qualify. Thus, the credit is widely regarded as being strongly "pro-family."

The credit is also widely regarded as being strongly "pro-work." Adults who do not work do not qualify. Moreover, while welfare benefits fall as earnings rise, thereby decreasing the returns from working for the very poor, the EITC rises with earnings for the very poor. For example, in 1989, a family receives a 14 cent credit for each dollar earned up to $6,500. The credit does not begin to phase out until earnings exceed $10,240, and then does so at a slow pace (10 cents for each dollar earned). Thus it provides incentives for the poor to work and earn more.

The credit is also "refundable." This means that if the credit for which a family qualifies exceeds the family's income tax liability, the family receives a check from the Internal Revenue Service for the difference. Thus, if a family has income too low to owe federal income tax but qualifies for a $600 EITC, the IRS will send the family a check for $600. The refundable aspect of the credit was designed as a way to help offset the high burden of regressive payroll taxes (i.e., Social Security and Medicare taxes withheld from paychecks) that low income working families still must pay regardless of whether they owe any income tax.

The EITC enjoys support from across the political spectrum and in the past two years, the idea of expanding the EITC through family size adjustments has gained an impressive number of both conservative and liberal adherents. Its virtues have been extolled by President Reagan's Task Force on Families (staffed by then-White House aide Gary Bauer), leading Republican and Democratic Members of Congress, respected poverty analysts such as David Ellwood and Robert Reischauer (the recently-appointed director of the Congressional Budget Office), and organizations as disparate as the Children's Defense Fund and the Heritage Foundation. (The Heritage Foundation has been circulating a proposal to adjust the credit by the number of young children in a

family; the proposal would phase in over four years, reaching a cost of $4.5 billion in the fourth year.)

VI. EITC Expansion and Minimum Wage Restoration Are Complementary Policies

Some proponents of EITC expansion have suggested that it could substitute for restoration of the lost value of the minimum wage. Yet even substantial expansion of the EITC should not be regarded as a substitute for raising the minimum wage. Such expansion would still leave families with children far below the poverty level if they rely on a full-time worker at the current minimum wage. At the same time, restoring the value of the minimum wage without expanding the EITC would also leave many families with full-time minimum wage workers well below the poverty line.

EITC Expansion Alone Is Not Sufficient

The Employment Incentives Act introduced in February 1989 by Reps. Thomas Downey, George Miller, and John Lewis, by Senator Albert Gore, and by a number of co-sponsors is an example of one of the more generous proposals to expand the EITC by family size. The EITC component of this proposal would provide for a maximum credit for families with two or more children of $1,950 (in 1989 dollars). This is more than twice as large as the maximum credit of $910 provided under current law.[9]

The Downey proposal thus represents a significant expansion in the credit. Yet even under this bill, the income of a full-time worker earning the current minimum wage would remain well below the poverty line. The disposable income of a family with two children that has full-time earnings at the current minimum wage would still fall $1,500 short of the income required to lift a family of three out of poverty -- and nearly $4,300 short of the income required to lift a family of four out of poverty.[10]

---

9. The Downey bill would also make the dependent care tax credit refundable, which would represent an important gain for low income working families with child care costs. Currently, working families with earnings too low to owe federal income tax do not benefit from the credit. As a result, while the credit helps to defray a portion of the child care costs incurred by middle and upper income families, it defrays none of the child care costs of working poor families. Making the credit "refundable" would extend its benefits to working poor families. The Bush Administration has also advanced such a proposal.

10. These calculations add the value of minimum wage earnings at 40 hours a week for 52 weeks a year, plus the value of the EITC, and subtract payroll taxes. If the EITC is added in, payroll taxes must be subtracted since the EITC is intended to offset payroll taxes. (While some of these families would also receive food stamps, the percentage of such families that would get food stamps is quite small. Some working families at this income level do not qualify for food stamps because they do not meet the program's stringent limits on assets. In addition, only a minority of those low income working households who do qualify for food stamps actually receive them. A

(continued...)

Effect of Raising EITC to $1,950 for Families With Two Children at Current Minimum Wage (in 1989 dollars)

Full-time minimum wage earnings$	6,968
Current EITC	910
EITC expansion to $1,950 for families with two children+	1,040
Payroll taxes (7.5 percent of earnings)	-523
Disposable Income	8,395
Poverty line for a family of three	9,887
Amount that income falls below the poverty line	-1,492
Poverty line for a family of four	12,677
Amount that income falls below the poverty line	-4,282

The Family Living Wage Act introduced recently by Rep. Thomas Petri and 17 co-sponsors is another example of a generous EITC proposal. Under this legislation, the credit would be increased by up to $640 for each pre-school child and up to $320 for each school-age child, (in 1989 dollars) up to a maximum of four children. Yet the large expansion of the EITC under this bill -- like the expansion under the Downey bill -- would leave families with full-time minimum wage earnings well below the poverty line. For example, a family of four with one pre-school child and one school-age child would still be $4,300 below the poverty line. (See box on next page for a more detailed discussion of both the Employment Incentives Act and the Family Living Wage Act.)

An increase in the EITC that would have as much impact on families with a full-time minimum wage worker at the current minimum wage as a restoration of the minimum wage to its levels of the 1960s and the 1970s (when full-time minimum wage earnings generally were above the three-person poverty line) would need to be extremely large -- much larger than any EITC expansion currently under consideration. To increase the credit enough to raise the income of a three-person family with a full-time worker at the current minimum wage to the poverty line would require nearly *quadrupling* the maximum value of the EITC, from $910 to $3,442. This would add billions in new costs. (The current EITC itself costs approximately $5.5 billion.)

Moreover, if an EITC expansion also attempted to lift families of four with a full-time minimum wage worker at the current minimum usage out of poverty, the cost

---

10. (...continued)
recent study by the U.S. Department of Agriculture found that only 37 percent of households with earnings who are eligible for food stamps actually receive them; most eligible low income working households do not apply for food stamp assistance. Accordingly, food stamp benefits were not included in these computations.)

EITC Proposals Fall Short of Goal

Several proposals to expand the EITC have been introduced in Congress this year. The lead sponsors of two of the most prominent proposals are Rep. Thomas Downey (a Democrat) and Rep. Thomas Petri (a Republican). Both proposals call for large EITC expansions (for example, the EITC expansion in the Downey bill would cost about $5 billion annually in 1989 dollars). Nonetheless, at the current minimum wage, both proposals fall well short of the goal of lifting full-time minimum wage workers and their families out of poverty.

Under the **Downey** bill, the maximum credit a family could receive would be raised from its current level of $910 to $1,365 for a family with one child and to $1,950 for a family with two or more children (these figures are all in 1989 dollars). The credit would equal 21 percent of the first $6,500 in earnings for a family with one child and 30 percent of the first $6,500 in earnings for a family with two or more children.

This EITC expansion would be very substantial. Yet it would still leave the disposable income of families with full-time earnings at the current minimum wage thousands of dollars below the poverty line. The poverty gaps would remain large.

Amount by which family income falls below the poverty line under Downey bill, at current minimum wage

1 Parent Family of Three	-$1,492
2 Parent Family of Three	-2,077
2 Parent Family of Four	-4,282
2 Parent Family of Five	-6,603

The **Petri** bill would also significantly enlarge the EITC. The value of the credit would be increased for each pre-school (age 0 to 5) and school-age child (age 6 to 15), up to four children. A family with one pre-school child and one school-age child would receive a credit of 30 percent of its first $6,377 in earnings for a maximum credit of $1,913 (these figures are also in 1989 dollars). The bill phases in benefits over essentially the same range as under current law, but benefits would begin to be reduced sooner than under current law.

The Petri bill enlarges the EITC by about $7 billion a year.* But it, too, would leave families with full-time minimum wage earnings far short of the poverty line.

Poverty gap under Petri at current minimum wage

1-Parent Family of Three (1 pre-school and 1 school-age child)	-$1,529
2-Parent Family of Three (1 pre-school child)	-1,847
2-Parent Family of Four (1 pre-school and 1 school-age child)	-4,319
2-Parent Family of Five (2 pre-school children and 1 school-age child)	-6,002

*The Petri bill would "pay" for a large part of this expansion by repealing the Dependent Care Tax Credit, which assists certain families with child care expenses. The Downey bill would not repeal the Dependent Care Tax Credit; rather it extends the Dependent Care Credit to low income working families with child care costs by making the credit "refundable." The Downey bill pays for its expansions by raising the top income tax rate for wealthy taxpayers from 28 percent to 33 percent.

increases would be even steeper. Such an expansion would require sextupling the maximum credit for such families, from $910 to more than $6,000.

Given the extremely high costs of an EITC expansion large enough to lift families with a full-time worker at the current minimum wage out of poverty, federal budgetary constraints essentially dictate that there be a shared public/private responsibility for addressing the problems of the working poor. The costs are far too large to be accomplished solely through an expanded public sector program, such as the EITC. Furthermore, with a private sector component (with additional earnings provided through a boost in the minimum wage floor), there is the additional advantage that a worker has higher earnings from a private paycheck.

A shared public/private approach is also necessary because an EITC expansion large enough, by itself, to lift working families out of poverty would almost certainly necessitate the imposition of very high marginal tax rates on low-income working families. Marginal tax rates would likely be as high as 60 to 80 percent.[11] This, in turn, could create new work disincentives.

It also bears noting that an EITC family size adjuster would not assist single individuals and childless couples who are low-wage workers, since households without dependent children are not eligible for the EITC. By contrast, an increase in the minimum wage would help these workers.

---

11. For example, consider an EITC expansion large enough to lift a family of three out of poverty without increasing the income limits at which a family ceases being eligible for the credit ($19,340 in 1989). A family with earnings at the minimum wage would need to receive a credit of $3,442. For benefits to phase down to zero by $19,340, it would be necessary to reduce benefits by about 34 cents for each additional dollar earned over the phase-out range. Add in federal income and payroll taxes for those in the upper part of this range, as well as state income taxes, and many working families in the $11,000-$19,000 range would face a combined marginal tax of at least 60 percent.

An EITC expansion large enough to lift a family of *four* out of poverty without raising the EITC income limits would require that the maximum EITC credit be reduced at least 50 cents for each additional dollar earned. Add in federal income and payroll taxes and state income taxes, and the combined marginal tax rate for many families in the $13,000 to $19,000 range would exceed 75 percent.

It would be possible to lower these marginal tax rates by raising the EITC income limits and phasing down EITC benefits at a slower rate as a family's income rose. However, this would make large numbers of middle-income families eligible for the program and add very substantially to its cost.

Minimum Wage Restoration Alone Is Not Enough

Restoring the minimum wage to its historic level of support would also, by itself, be insufficient to address the serious income problems of many working poor families with children. If the minimum wage were returned to a level sufficient to lift a family of three with a full-time worker out of poverty, larger families would remain in poverty. For example, a family of four with a full-time minimum wage worker would be left $2,600 below the four-person poverty line (after the benefits of the current EITC are added and payroll taxes are subtracted).

In short, to move towards the goal of ensuring that full-time working families are lifted out of poverty, neither expanding the EITC by itself, nor restoring the minimum wage by itself, will suffice. A combination of both steps is needed.

VII. Dimensions of a Combined Package

It is possible that during this session, Congress could both expand the EITC and increase the minimum wage. If this occurs, the dimensions of the changes in both the EITC and the minimum wage will determine how close the nation comes to the goal of lifting families with a full-time worker out of poverty.

The Employment Incentives Act (the Downey bill) and the Family Living Wage Act (the Petri bill) reflect the largest EITC expansions that are likely to be seriously considered in this Congressional session or in the near future. If Congress does adopt a bill to adjust the EITC by family size, it is more likely that either a scaled-down version of one of these bills or another, smaller bill will be what is ultimately exacted.

But even if it is assumed that either the Downey bill or the Petri bill is adopted intact, once these are coupled with the increases in the minimum wage now being considered, the result is a policy package that falls short of the goal.

The largest increases in the minimum wage now under consideration are the increases reflected in minimum wage legislation scheduled to be taken up shortly on the House and Senate floors. This legislation, sponsored by Senator Edward M. Kennedy and Rep. Augustus Hawkins, would provide for three annual increments in the minimum wage, ultimately establishing a minimum wage of $4.65 an hour in 1992.

If both the Kennedy/Hawkins minimum wage bill and the Downey bill were enacted, a single-parent family of three with a full-time minimum wage earner would fall a modest amount -- $126 -- below the poverty line. However, a two-parent family of four with full-time minimum wage earnings would fall more than $2,900 below the poverty line.

Similarly, if the Kennedy/Hawkins bill and the Petri proposal were to become law, the single-parent family of three would fall $302 below the poverty line, while the family of four would fall short of the poverty line by nearly $3,100.

Furthermore, if both a minimum wage increase and an EITC expansion were adopted -- but either or both were scaled back from the levels of the Kennedy/Hawkins bill and of the Downey or Petri bills -- working families would be left still further below the poverty line.

For example, the Bush administration has proposed an increase in the minimum wage to $4.25 an hour in 1992, or nearly 10 percent lower than under Kennedy/Hawkins. (The Bush administration proposal differs from the Kennedy/Hawkins proposal in one other significant respect; the Bush proposal would exempt all newly-hired workers from the minimum wage law for six months.) When packaged with an EITC increase, the Bush proposal would yield disposable income $600 to $700 lower for a full-time working family -- and further short of the goal -- than if the Kennedy/Hawkins proposal were adopted.

Thus, while the Kennedy/Hawkins bill, when combined with the Petri bill, yields disposable income that falls about $300 short of the poverty line for a single-parent family of three, a Bush/Petri combination would fall nearly $900 short. For a two-parent family of four with a full-time minimum wage worker, the Kennedy/Hawkins bill when combined with the Downey bill yields disposable income that falls about $2,900 short of the poverty line -- but a Bush/Downey combination falls nearly $3,600 short.[12]

Amount that income falls short of poverty line under Kennedy/Hawkins when combined with

	Downey	Petri
1-Parent Family of Three	$ - 126	$ - 302
2-Parent Family of Three	- 711	- 609
2-Parent Family of Four	- 2,916	- 3,092

Amount that income falls short of poverty line under Bush proposal when combined with

	Downey	Petri
1-Parent Family of Three	$ - 799	$ - 887
2-Parent Family of Three	- 1,384	- 1,202
2-Parent Family of Four	- 3,589	- 3,677

12. These figures reflect the value of the minimum wage and the EITC in years when the proposals are fully implemented, but are expressed in 1989 dollars.

If the EITC proposal ultimately adopted is smaller than the Downey or Petri proposals, the amounts by which families would fall short of the poverty line would be larger than the figures shown here.

VIII. A Two-handed Boost for the Working Poor

A combined approach would: (1) restore the minimum wage so that it again provides enough earnings for a three-person family with a full-time worker to escape poverty; and (2) adjust the EITC by family size so that larger families would receive more assistance. This combined approach is recommended by Professor David Ellwood of the John F. Kennedy School of Government at Harvard in his recent book *Poor Support: Poverty in the American Family.*

The minimum wage legislation sponsored in the House (H. 2) by Rep. Hawkins and in the Senate (S. 4) by Senator Kennedy would establish a wage floor of $4.65 an hour in 1992. This legislation is modest when compared to the minimum wage levels of the 1960s and 1970s. (It is also modest when compared to the original Kennedy/Hawkins minimum wage legislation introduced in 1987, which would have raised the minimum wage to approximately $5.50 an hour by 1992.) It would take the minimum wage about halfway toward the traditional wage standard, raising it in 1992 to a level at which full-time minimum wage earnings would equal 85.5 percent of the projected poverty line for a family of three, falling about $1,400 short of this standard (see Table A-1 in the Appendix). When EITC benefits under current law and payroll taxes are taken into account, a family of three with a full-time worker would still fall more than $1,150 below the poverty line.

If, in addition, a sizable EITC family-size adjuster were adopted, however, the nation would move considerably closer to the goal of ensuring that if a parent works full-time, the family would not have to live in poverty. Nevertheless, the goal would still not be fully met, even under the most generous EITC expansions that have been proposed.

While the dimensions of the income problems faced by working poor families are large, the policy tools to address these needs are at hand. This is not an area where it is unclear whether anything will work or have more than a marginal impact. By restoring the value of the minimum wage and expanding the EITC by family size, this Congress could significantly reduce poverty, especially among families with children, and also take an important step toward affirming the value of work in our society.

APPENDIX A

VALUE OF THE MINIMUM WAGE

The minimum wage has not been increased since January 1981, even though consumer prices have increased by 39 percent during this period. As a consequence, the value of today's minimum wage is substantially below three benchmarks that are commonly used to assess its worth.

Below Historic Level of Purchasing Power. In 1989 dollars, the inflation-adjusted value of the minimum wage averaged $4.97 per hour in the 1960s, $4.88 in the 1970s, and $4.57 in 1981. *The inflation-adjusted or real value of the minimum wage is now the lowest it has been since 1955.*

Below Poverty Wage for a Family of Three. In the 1960s and the 1970s, full-time minimum wage earnings averaged 103.6 percent of the poverty line for a family of three. In 1989, these earnings will fall 29 percent or $2,900 below the projected three-person poverty line.

Below Half the Average Wage. In the 1950s and 1960s, the minimum wage averaged more than half of the average nonsupervisory private wage. In 1989, it will equal 34.4 percent of the projected average wage.

House and Senate Bills Provide Substantial Improvement But Fall Short of Benchmarks

Legislation recently adopted by the Senate Labor and Human Resources Committee (S. 4) and the House Education and Labor Committee (H. 2) provide for three annual increments in the minimum wage between now and 1992, so that the wage floor would be raised to $4.65 an hour by 1992. This legislation is considerably more modest than the Kennedy-Hawkins minimum wage legislation introduced in 1987, which would have raised the minimum wage to approximately $5.50 an hour by 1992.

The pending legislation would restore a significant part -- but not all -- of the lost value of the minimum wage. The legislation would leave the minimum wage well short of the three traditional benchmarks described above.

- The minimum wage in 1992 would be 59 cents an hour below its 1981 inflation-adjusted value.
- Full-time minimum wage earnings in 1992 would equal 85.5 percent of the estimated poverty line for a family of three, or $1,400 less than the poverty standard (in 1989 inflation-adjusted dollars).
- In 1992, the wage floor would equal 41.7 percent of the projected average wage, substantially below the 50 percent benchmark.

The legislation should thus be considered modest.

Administration Proposal Falls Even Further Below Benchmarks

The Bush administration has proposed increasing the minimum wage to $4.25 an hour in 1992; this proposal would fall substantially further below the benchmarks than would H. 2 and S. 4. Under the Bush administration proposal:

- The minimum wage in 1992 would be nearly $1 below its 1981 inflation-adjusted value.
- Full-time minimum wage earnings in 1992 would equal only 78.1 percent of the estimated poverty line for a family of three.
- The minimum wage in 1992 would equal only 38.1 percent of the average wage.

The very modest expansion of the minimum wage that would occur under the Bush administration proposal is further illustrated by the following comparisons.

- In 1992, a minimum wage of $4.25 an hour would be lower than it was in every year from 1956 to 1986, after adjusting for inflation. Such a minimum wage level only restores the purchasing power of the wage to about the same level as in 1987, six years after its previous adjustment in 1981.
- The value of the minimum wage in 1992, after adjusting for inflation, would only be five percent higher than its value in 1988, when President Bush first endorsed an increase.

Table A-1. Projected Value of the Minimum Wage

	Minimum Wage Value	Min Wage as a % of projected Poverty Level for a Family of Three	Min Wage As a percentage of projected Average Wage	Value of 1981 Min Wage if it kept pace with Inflation
Under Current Law				
1989	$3.35	70.5%	34.4%	$4.57
1990	3.35	67.2	32.8	4.79
1991	3.35	64.3	31.3	5.01
1992	3.35	61.6	30.0	5.24
Under House and Senate Bills (H. 2 and S. 4)				
1989	$3.35	70.5%	34.4%	$4.57
1990	3.85	77.3	37.7	4.79
1991	4.25	81.5	39.8	5.01
1992	4.65	85.5	41.7	5.24
Under Administration Proposal				
1992	4.25	78.1	38.1	$5.24

Notes on Calculations:

The projections above are based on the most recent inflation estimates of the Congressional Budget Office. CBO projects inflation of 4.9 percent in 1989, 4.9 percent in 1990, 4.6 percent in 1991, and 4.4 percent in 1992. Minimum wage earnings relative to the poverty line for a family of three are based on someone working full-time (52 weeks a year at 40 hours a week or 2,080 hours) at the minimum wage. The three-person poverty line and the average private nonsupervisory wage for 1989 to 1992 were estimated by adjusting the estimated 1988 levels by CBO's projected inflation rates.

Table A-2. Past Value of the Minimum Wage

Year	Current dollars	Percent of Poverty Line Family of 3	1989 Dollars	Percent of Average Nonsupervisory Wage
Average for:				
1960s	$1.29	104.6%	$4.97	52.2%
1970s	2.07	102.6	4.88	45.8
1980-89	3.32	83.9	3.99	40.4

Source: Center on Budget and Policy Priorities calculations based on U.S. Department of Labor and Congressional Budget Office data.

APPENDIX B

The Minimum Wage and Employment Opportunities

The principal argument raised against a minimum wage increase is that by raising the cost of labor, it would decrease employer demand for labor and for teenage workers in particular. However, updated studies, as well as the unique characteristics of the current labor market, suggest that the effect on employment opportunities of restoring the minimum wage is likely to be modest.

Virtually all of the estimates of large job losses stemming from a minimum wage increase are based on studies of pre-1980 labor markets. The best of the pre-1980 studies was conducted by the economists on the staff of the Minimum Wage Study Commission, established by Congress in 1977 to analyze the effects of the minimum wage. The Commission's economists reviewed all previous studies and conducted an updated study of their own. They found that a 10 percent increase in the minimum wage was associated with a one percent decrease in teenage employment and with a one-quarter of one percent decrease in the employment of young adults (20 to 24 years old). (The economists found no strong evidence of any job loss for adults 25 and over.) The economists summarized their central finding -- their estimate of the relationship between minimum wage increases and teenage employment levels -- as follows:

> Previous empirical studies had estimated that a 10 percent increase in the minimum wage (or in the fraction of workers subject to it) would reduce teenage employment by 1 to 3 percent. Our own work, which uses a more up-to-date and longer sample period than most of these studies, suggests that 1 percent is a reasonable "single-number" estimate of the employment effect.

Nonetheless, many of the job loss projections now cited in the current minimum wage debate use estimates based on the high end of the range of the pre-1980 studies reviewed by the Commission, without noting that these estimates are substantially higher than those determined by the Commission's staff to be the most reasonable.

Moreover, even the job loss estimates of the Commission's staff are now outdated. Because they are based on labor market data only through 1979, they do not reflect the important differences between today's low wage labor markets and those of the 1960s and 1970s.

A new study, conducted by Alison Wellington of the University of Michigan under the supervision of one of the Commission's senior economists, Professor Charles Brown, has replicated and updated the work of the Commission staff with labor market data through 1986. This important work finds that a minimum wage increase of 10 percent is associated with a decrease of six-tenths of one percent in employment opportunities for teenagers (or slightly more than half of the one percent decrease found based on data through 1979) and has no measurable effect on the employment of young adults.

Furthermore, even this new study does not account for two other factors that would diminish the employment effects of the minimum wage increases now being considered. Twelve states and the District of Columbia have boosted their state minimum wage levels above the federal level. These states include populous California, which now has a minimum wage of $4.25 an hour. In these areas, the economic effects of restoring the federal minimum wage have been partially preempted, dampening any adverse employment effects that could result from changes in federal law.

In addition, the proposed legislation would expand the exemptions to the minimum wage, thus further moderating the legislation's effect on employment. For example, under the House bill (H. 2), retail or service firms with gross incomes of less than $500,000 would become exempt from coverage, an amount considerably higher than the current exemption limit of $362,500. For such newly exempt firms (which have more than one million workers), any potential employment effects are mitigated. The Senate bill (S. 2) goes even farther, exempting from coverage other small businesses (rather than just retail or service firms) with gross incomes under $500,000.

Several other aspects of the current low-wage labor market are consistent with estimates that a minimum wage boost would cause only modest job losses. First, the current minimum wage is at its lowest level, relative to the average wage, since 1949; the minimum wage is now 25 percent below its average relative value from 1954 to 1986 (the period covered by the Wellington study). As a result, the proportion of workers who work at or near the minimum wage is now considerably lower than in the past, and an increase in the minimum wage is thus likely to have a more modest upward "ripple" effect on other wages than in the past. Consequently, the effects of a minimum wage increase on employment are likely to be less significant today than the average employment effect in the past.

In addition, a shortage in the supply of teenage workers may be emerging. The number of 16-to-19 year olds rose in all but one of the 25 years preceding 1978, but has fallen sharply in the 1980s. The disemployment estimates cited above, including both those job loss estimates which are cited by opponents of a minimum wage and the estimates derived from the Wellington study (which covered the years 1954 to 1986), are based primarily on years when the youth population was rising. Such estimates may overstate the potential employment loss from a minimum wage increase that is likely to occur in periods when the youth population is falling, as it is now, and there consequently is less competition for jobs.

Furthermore, in the current minimum wage debate, as in past minimum wage debates, one factor that has been overlooked is that the labor market is more complex than is reflected in the simple theory that raising the level of wages decreases demand for labor. Higher wages may enhance job stability and commitment among workers, not minor factors in low wage labor markets often characterized by quick job turnover. Hence, employee productivity may be boosted. Employers, in turn, may respond to a minimum wage hike by reorganizing some production processes to make better use of existing employees. As a result of this potential for increased productivity, the actual of labor may not rise as much as the increase in the minimum wage, and the d for labor may decrease less than expected.

Striking a Reasonable Balance

While the potential employment effects of a minimum wage increase should not be ignored, other factors also deserve consideration in assessing the merits of an increase.

First, and most obviously, there is the increased income support that would be provided to millions of minimum wage workers and many of the working poor.

Second, the minimum wage represents a statement by society that pay for work should meet certain basic standards. A labor standard implies that certain conditions of employment -- such as minimally adequate pay or safety -- should be required, even though these conditions impose some costs on employers. By contrast, continuing to freeze the minimum wage at $3.35 an hour while prices continue to rise would suggest that society is willing to accept the minimum wage's gradual erosion to the point where it may cease to have much meaning as a standard.

Policymakers should seek to set the minimum wage at a level that balances the objectives of minimizing employment loss, maintaining adequate labor standards, and providing for income support. Restoring the minimum wage to its traditional level -- where working full-time at the minimum wage provides earnings equal to the poverty line for a family of three -- would strike a reasonable balance.